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**COUNTY OF MONTEREY**

**Management Report  
For the Year Ended June 30, 2009**

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**COUNTY OF MONTEREY**

Management Report  
For the Year Ended June 30, 2009

Table of Contents

	<u>Page</u>
Introduction.....	1-2
Required Communication .....	3-6
<u>Comments Pertaining to Officials and Departments – Current Year</u>	
Risk Programs Reported in the General Fund .....	7-8
Payroll/Personnel Functions .....	9
<u>Status of Prior Year Recommendations</u>	
Auditor-Controller .....	10-11
Various Departments .....	11



GALLINA<sup>LLP</sup>

CERTIFIED PUBLIC ACCOUNTANTS

To the Honorable Members of the  
Board of Supervisors  
of the County of Monterey  
Salinas, California

In planning and performing our audit of the basic financial statements of the County of Monterey (County) for the fiscal year ended June 30, 2009, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

However, during our audit we became aware of matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions and the status of our comments and suggestions concerning certain recommendations made in the County's prior year audit. We previously reported on the County's internal control in our report dated December 18, 2009. This letter does not affect our report dated December 18, 2009, on the financial statements of the County of Monterey.

Monterey County's management has provided responses to the comments described in the memorandum that accompanies this letter. We did not audit the County's responses and accordingly, we express no opinion on it.

This report is intended for the use of management, the Board of Supervisors, the Grand Jury and officials of the federal and state grantor agencies.

We thank the County's staff for its cooperation during our audit.

A handwritten signature in black ink that reads "Gallina LLP". The signature is written in a cursive, flowing style.

December 18, 2009  
Roseville, California

## COUNTY OF MONTEREY

### Management Report Required Communication For the Year Ended June 30, 2009

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the County of Monterey (County) for the year ended June 30, 2009, and have issued our report thereon dated December 18, 2009. Professional standards require that we provide you with the following information related to our audit.

#### **The Auditor's Responsibility under U.S. Generally Accepted Auditing Standards and OMB Circular A-133**

As stated in our engagement letter dated June 3, 2009, our responsibility, as described by professional standards, is to express opinions about whether the financial statements represented by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

In planning and performing our audit, we considered the County's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As part of obtaining reasonable assurance about whether the County's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. Also, in accordance with OMB Circular A-133, we examined, on a test basis, evidence about the County's compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement applicable to each of its major federal programs for the purpose of expressing an opinion on the County's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the County's compliance with those requirements.

#### **Planned Scope and Timing of the Audit**

We performed the audit according to the planned scope and timing previously communicated to you in our engagement letter dated June 3, 2009.

# COUNTY OF MONTEREY

## Management Report Required Communication For the Year Ended June 30, 2009

### **Significant Audit Findings**

#### *Significant Accounting Policies*

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the County are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. We noted no transactions entered into by the County during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

#### *Accounting Estimates*

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate(s) affecting the financial statements were:

- Allowance for uncollectible accounts: Management's estimate is based on past experience and subsequent collections. We reviewed management's calculation of the allowance.
- Claims liability: Management's estimate is derived from actuarial valuations obtained from experts. We agreed the claims liability reported in the financial statements to those reported in actuarial reports prepared and issued during the year being audited.
- Liability for solid waste landfill closure and postclosure costs: Management's estimate is based on engineering estimates of future costs to be incurred. We reviewed the engineer's estimate.

### **Difficulties Encountered in Performing the Audit**

We encountered no significant difficulties in dealing with management in performing our audit.

## COUNTY OF MONTEREY

### Management Report Required Communication For the Year Ended June 30, 2009

#### **Corrected and Uncorrected Misstatements**

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. The following summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

- Reverse prior year adjustment for 3 months of payment to CSAC at June 30, 2008, and record adjustment for accrual of 3 months of payment to CSAC at June 30, 2009. Net effect of this adjustment was to decrease general government expenditures by \$2,507.

The following material misstatements detected as a result of audit procedures were corrected by management:

- Long-term receivables and unearned revenues were reduced by \$119,630 in fund 14 for borrowers having filed bankruptcy. Collection of the remaining principal balance was considered highly doubtful.
- Decrease fund balance reserved for future payment of County debt by \$3,421,756 to agree to amounts required to be set-aside by bond indenture agreements.

#### **Disagreements with Management**

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

#### **Management Representations**

We have requested certain representations from management that are included in the management representation letter dated December 18, 2009.

#### **Consultations with Other Independent Auditors**

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

**COUNTY OF MONTEREY**

Management Report  
Required Communication  
For the Year Ended June 30, 2009

**Other Audit Findings or Issues**

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the County's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of the Board of Supervisors and management of the County of Monterey and is not intended to be and should not be used by anyone other than these specified parties.

COUNTY OF MONTEREY

Management Report  
Comments Pertaining to Officials and Departments – Current Year  
For the Year Ended June 30, 2009

**RISK PROGRAMS REPORTED IN THE GENERAL FUND**

Criteria

The principal purpose of fund accounting is to demonstrate fiscal accountability.

Generally Accepted Accounting Principles permit the use of internal service funds in cases where centralized services are provided on a cost-reimbursement basis to participating funds. Although not required, the internal service fund is best designed to measure the full cost of providing goods or services for the purpose of fully recovering that cost through fees or charges to participating departments.

The use of agency funds is limited to circumstances where assets are held in a trustee or agency capacity for others and cannot be used to support the government’s own programs. A government is considered to be holding assets for which it performs the investment function or with which it has significant administrative involvement.

Condition

The County uses fund 40 to account for several miscellaneous insurance programs that include dental, vision, employee assistance, long-term disability, retiree sick leave conversion and dependent care benefit programs. The benefits are funded 100% with employee contributions. Rates are set to cover premiums paid to a third-party insurer with a component built in to provide a reasonable surplus for unexpected claims. The fund is accounted for like an agency fund where revenues and expenditures are not recognized but netted in separate liability accounts. At June 30, 2009, the fund had the following account balances:

Cash and investments	\$ 6,234,855
Accounts payable	(284,248)
Claims liability	(693,910)
Net balance held in reserve	<u>\$ 5,256,697</u>

Cause

Because this fund is funded 100% with employee contributions, the cost of providing the benefit programs is netted against the reimbursements collected from employee paychecks and reported as a liability of the general fund. The fund’s cash and investments, accounts payable and claims liability are also combined with the general fund for reporting purposes. However, the assets of fund 40 are not available to fund general fund obligations. The general fund’s assets are not available to satisfy the obligations, including the claims liability, of fund 40.

**COUNTY OF MONTEREY**

Management Report  
Comments Pertaining to Officials and Departments – Current Year  
For the Year Ended June 30, 2009

**RISK PROGRAMS REPORTED IN THE GENERAL FUND (continued)**

Effect of Condition

Because the benefits of fund 40 are entirely funded by employee contributions, fund 40 assets and obligations should not be aggregated with the County's general fund. By aggregating fund 40 with the general fund, financial reporting does not accomplish the objective of demonstrating fiscal accountability.

Recommendation

We recommend management consider the use of an agency fund type or an internal service fund type to account for the benefit programs included in existing fund 40.

Management Response

We agree with this finding and recommendation. This project is in the planning phase and will be finalized after the implementation of the new ERP-Advantage system in FY 2009-2010. An Internal Service fund will be established to account for this program.

# COUNTY OF MONTEREY

## Management Report Comments Pertaining to Officials and Departments – Current Year For the Year Ended June 30, 2009

### PAYROLL/PERSONNEL FUNCTIONS

#### Criteria

Segregation of incompatible functions is critical to good internal control policies. In the area of payroll, the functions of human resources that include maintaining personnel files, pay rates, adding employees and removing employees should be segregated from the function of payroll processing. The risk of fraud is significantly reduced when the functions are segregated not just with departments and paper documents but also by means of a software solution.

#### Condition

We observed that the Auditor-Controller's office is responsible for maintaining personnel records as well as handling payroll functions. This was a prior year condition.

#### Effect of Condition

The effect of this condition results in a lack of segregation of duties between the personnel functions, which are usually handled by the Human Resources department, and the payroll function. It is imperative that these functions be segregated. In most Counties, especially the larger ones, the Human Resources department maintains personnel files, including the updating of pay rates, obtaining approvals for withholdings and deductions, and approvals for direct depositing, etc. If the Auditor-Controller's office has the ability to change pay rates and handle other details of personnel files, then errors or fraud could occur and not be detected in a timely manner.

#### Recommendation

We recommend that the functions of personnel and payroll be separated by transferring the duties of the personnel functions from the Auditor-Controller's office to the Human Resources department.

#### Management Response

We agree with this finding and recommendation. The County is currently implementing a "new" payroll system that will address these issues. Implementation of this ERP package should be completed by the close of the FY 2009-2010.

# COUNTY OF MONTEREY

Status of Prior Year Recommendations  
June 30, 2008

<u>Recommendation</u>	<u>Status</u>
<b><u>AUDITOR-CONTROLLER</u></b>	
<u>Payroll/Personnel Functions</u>	
We recommend that the functions of personnel and payroll be separated by putting the duties of the personnel functions in the Human Resources department.	Not implemented
<u>Disaggregation of Receivables</u>	
We recommend the County modify its chart of accounts to include separate accounts for accounts receivable, taxes receivable and amounts due from other governments. Year-end closing procedures should be modified to capture receivable balances into each of these accounts according to their nature.	Alternative process implemented
<u>Record Property Taxes Receivable in the Funds</u>	
We recommend the County calculate and record property taxes receivable in each fund being apportioned property taxes. The County should consider establishing an allowance for uncollectible property taxes. In governmental funds, adjustments should be made for the revenue availability period.	Implemented
<u>Risk Programs Reported in General Fund</u>	
We recommend management consider the use of an agency fund type or an internal service fund type to account for the benefit programs included in existing fund 40.	Not implemented
<u>Maintaining Natividad General Ledger Account Balances</u>	
As Natividad produces a monthly financial report that includes all of its transactions from all sources, we recommend the County reconcile its balances with the external report and update its general ledger balances to accurately reflect all transactions and balances for Natividad.	Not Implemented Alternative process in place pending completion of ERP installation

**COUNTY OF MONTEREY**

Status of Prior Year Recommendations  
June 30, 2008

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Recommendation	Status
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**AUDITOR-CONTROLLER** (Continued)

Accounting and Reporting Transfers

We recommend the transactions identified above be recorded appropriately as revenue or expenditures as indicated. We also recommend that the Auditor-Controller's Office balance the incoming and outgoing transfer accounts during the closing process so that discrepancies can be identified and corrected.

Implemented

**VARIOUS DEPARTMENTS**

Payroll/Personnel Functions

We recommend that where possible the functions of initiating hiring and entering the time for all employees be segregated and performed by separate individuals. While we understand that a complete segregation of duties is impractical in a small department with limited personnel, we believe that some relatively minor changes could be made that would significantly improve controls. These duties can be rotated among department staff or someone else outside the department could be assigned to learn how to perform these duties and to actually perform them periodically to reduce the chance of errors and fraud from occurring and not being detected in a timely manner.

Not Implemented